



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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REPORT
No. 90-090

June 29, 1990

MEMORANDUM FOR THE DIRECTOR NATIONAL SECURITY AGENCY/CHIEF,
CENTRAL SECURITY SERVICE
CHIEF, BAD AIBLING STATION

SUBJECT: Report on the Audit of the Morale, Welfare, and
Recreation Fund, Bad Aibling Station, West Germany
(Project No. 0FA-0001)

Introduction

This is our final report on the Audit of the Morale, Welfare, and Recreation Fund (the Fund), Bad Aibling Station (the Station), West Germany. The objectives of the audit were to determine whether the financial statements presented fairly the financial condition and results of operations of the Fund, and to determine whether internal control deficiencies identified in our prior reports had been corrected.

Scope of Audit

We reviewed the financial statements and operations of the Fund for the period October 1, 1988, to September 30, 1989. We made judgmental samples and other selective tests of financial records, accounting procedures, and internal controls to establish the reliability of data used by the Station for internal purposes and external reporting. We also examined the charter, the bylaws, and the minutes of the board of directors' meetings to determine whether the rules and policies pertaining to the Fund were effectively implemented. The items we tested were generally in compliance with applicable directives and regulations, and there was no indication that items we did not test were not in compliance. The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. This financial and compliance audit was made during September and October 1989 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of the internal controls as were considered necessary.

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Background

Prior to October 1, 1988, Bad Aibling Station operated two Nonappropriated Fund Instrumentalities: the Consolidated Open Mess and the Community Activities Fund. On October 1, 1988, these funds were consolidated into the Bad Aibling Station Morale, Welfare, and Recreation Fund. The Fund was established "... to provide programs to enhance the physical and mental well-being of military and civilian personnel and family members assigned to Bad Aibling Station." Programs include a sports center, library, travel service, snack bar, bowling center, child development center, youth activities, club operations, craft shops, and visitors' quarters. The Fund is authorized by DoD Directive 1015.1, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities"; Army Regulation 215-1, "Administration of Morale, Welfare, and Recreation Activities NAFI"; and NSA Headquarters Regulations 12-1, "The NSA/CSS Morale, Welfare, and Recreation (MWR) Program," 12-5, "Safeguarding NSA/CSS Nonappropriated Funds," and 12-13, "Morale, Welfare, and Recreation Activities at NSA/CSS Field Elements."

Prior Audit Coverage

In 1986, the Inspector General, DoD audited the two funds that preceded the Fund.

Audit Report No. 87-150, "Report on the Audit of the Community Activities Fund, Bad Aibling Station, West Germany," was issued on May 19, 1987. This report stated that the dollar value of the fixed assets could not be verified and that internal controls necessary to protect fund assets were lacking. Also, fund management did not always follow Army regulations governing the operation and management of nonappropriated funds, and accounting records were not maintained in accordance with generally accepted accounting principles. The report contained 32 recommendations needed to resolve the deficiencies identified during the audit.

Audit Report No. 87-151, "Report on the Audit of the Consolidated Open Mess, Bad Aibling Station, West Germany," was also issued on May 19, 1987. This report stated that the values of accounts receivable and fixed assets could not be verified. The report also stated that management at the Consolidated Open Mess (the Club) had not complied with Army regulations governing the Club's operation, and had deviated from generally accepted accounting principles in the maintenance of financial accounting records. The report contained 29 recommendations.

Both of the prior reports identified internal control deficiencies as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive (DoDD) 5010.38.

Station management implemented all except one of the recommendations in our prior reports. The recommendation and the finding are stated below:

Establish separate files for contract and blanket purchase agreements and maintain these files in accordance with Army Regulation (AR) 215-4, "Nonappropriated Fund Contracting." (Contract files did not contain required documentation.)

Overall, Bad Aibling Station had made considerable improvements in its Fund operations and was complying with DoD Directives and the 215 series of Army Regulations on Morale, Welfare, and Recreation Activities. Station management took commendable actions to implement the recommendations in the prior reports. We noted the following actions by management, which demonstrated its commitment to correcting those conditions:

- creating, within the Office of the Executive to the Chief of Station, an internal review function to oversee the implementation of corrective actions;
- establishing a system to track DoD, IG audit recommendations;
- establishing a Central Accounting Office and hiring an accountant as its chief;
- assigning a Finance and Accounting Officer who had demonstrated leadership and technical ability in implementing needed changes; and
- procuring an accounting software package to assist in financial management of the Fund.

In addition, National Security Agency (NSA) headquarters personnel made field visits to Bad Aibling Station to review and evaluate corrective actions by the Station.

Discussion

We believe that the Balance Sheet in Enclosure 1, subject to the finding above and those findings cited below, presents fairly the financial condition of the Fund as of September 30, 1989. Because we were not present to observe the inventories taken as of October 1, 1988, and did not have alternative methods of confirming the inventory balances, we expressed no opinion on the Income Statement and the Statement of Cash Flows. These statements are also presented in Enclosure 1.

The Fund's operations conformed to DoD Directives, Army regulations, and generally accepted accounting principles. However, the following findings needed corrective actions to improve internal controls.

- Fund managers were not evaluated on their responsibilities for internal management controls. AR 215-3, "NAF and Related Activities Personnel Policies and Procedures," paragraph 6-5, gives criteria for performance standards for managers.

- While consolidating the two predecessor funds, the Fund manager wrote off \$65,712.34 of fixed assets and \$44,020.25 of accumulated depreciation. The net value of \$21,692.09 was debited to retained earnings. The write-off represented an adjustment of fixed asset accounts to the subsidiary ledgers. A physical inventory was taken in November 1988, resulting in the write-off of \$16,542.47 of fixed assets and \$15,788.92 of accumulated depreciation. The net value of \$753.55 was charged to loss on disposal of fixed assets. Under the circumstances, we agree with the adjustments made. To prevent the extensive write-off of fixed assets in the future, Fund managers should reconcile fixed asset subsidiary records with the general ledger on a monthly basis, and fixed assets should be physically inventoried on an annual basis.

- Fund management did not dispose of the Fund's assets properly. Amusement machines purchased for over \$28,000, with a book value of approximately \$6,000, were disposed of at an unspecified time, and were written off in September 1988. Documentation showed the assets were disposed of, but no other information was noted. In April 1989, a television set belonging to the Fund was disposed of and written off in the same manner. Fund personnel said the television set was simply discarded. AR 215-1, paragraph 12-13, gives the proper methods for disposal of fixed assets. The television set and amusement machines were not disposed of by approved methods.

- In December 1988, fixed assets valued at approximately \$16,500, having a book value of about \$750, were written off to reconcile with the physical inventory noted above. Missing items included a tape deck, a stereo receiver, three videocassette recorders, and two vehicles. The Fund was unable to produce any disposal documents for these items. The adjusting entry stated only that the assets were disposed of. AR 215-1, paragraph 14-2, requires that an investigating officer be appointed for losses exceeding \$500. No investigation was performed. We believe management needed to conduct an investigation to support the proper write-off of fixed assets.

- The Fund owned computer equipment that had been unused for at least 1 year. Fund personnel stated that some of

it was functional, and some was not reparable. The functional equipment had declined in resale value because of deterioration or obsolescence. The equipment should have been used or disposed of before we began our audit. The financial statements in our report were not adjusted to include a write-off of this retired equipment. Consequently, the fixed assets and cumulative depreciation accounts may be overstated by as much as \$13,814 and \$11,490, respectively. Retained earnings may be overstated by as much as \$2,324.

- A former small purchase contracting officer for the Fund exceeded the warrant limitation imposed by Fund management. A warrant limitation is the authority to purchase products and services for the Fund. The authority is granted to an individual by Fund management and has a dollar limit. The contracting officer's warrant limitation was \$5,000 per contract. In November 1988, the individual executed a purchase order for slot machines totaling \$9,690. We found no evidence that this transaction was ratified in accordance with AR 215-4, paragraph 1-24.

- Fund managers did not follow contracting regulations in AR 215-4. In July 1988, they contracted with a local beer distributor to construct a bar in the old Club. The contract was drafted by the distributor and signed by a Contracting Officer at Bad Aibling Station. It called for a specified amount of beer to be purchased, with the Fund paying higher than the established price for beer. This premium would be used to pay off, over a specified period of time, the liability for the construction of the bar. The contract exceeded the Contracting Officer's warrant. In addition, because required contracting procedures were not followed, the Fund's accounting office did not discover the acquisition until several months later. Our confirmation of accounts payable disclosed that the vendor considered the amount of the debt to be DM 3,508 (\$1,772) higher than the Fund's figure of Deutsche Mark (DM) 50,000 (\$25,253). Fund personnel have since determined that the higher figure was correct. The financial statements presented in this report have been adjusted accordingly.

- Lack of accountability over foodstuffs at the Consolidated Open Mess led to significant overages (\$1,100) and shortages (\$1,700) in the year-end inventory. These wide variances in both directions indicated a lack of adequate record-keeping.

- No stock record cards were kept on keg and bottle beer. This lack of controls would inhibit the detection of loss or theft of these items.

- Two Club employees had access to the controlled areas for liquor storage. Good internal controls dictate that only one

employee should have access to such items and be accountable for them.

- Official contract files did not contain documentation required by AR 215-4, "Nonappropriated Fund Contracting," paragraph 7-31. For example, in the seven contract files reviewed, we did not find appropriate sole source justification, records of negotiation, price quotes, and requests for proposals.

Recommendations

We recommend that the Director, National Security Agency/Chief, Central Security Service direct the Bad Aibling Station Fund Custodian to:

1. Incorporate internal control responsibilities in the performance standards for all Fund managers. Standards should be tailored to each manager's responsibilities.

2. Establish standard operating procedures for disposal of fixed assets. AR 215-1, paragraph 12-13, outlines procedures to be followed. Procedures should require the prompt identification and disposal of unused assets.

3. Appoint an investigating officer to determine the cause of lost property worth over \$500 from the Nonappropriated Fund Instrumentality.

4. On a monthly basis, reconcile fixed asset subsidiary records with the general ledger. This reconciliation should include related accounts.

5. Dispose of unused computer equipment or put it back into service. Unneeded assets should be disposed of in accordance with AR 215-1.

6. Comply with the provisions of AR 215-4, paragraph 1-6.f., Nonappropriated Fund Contracting. Nonappropriated fund contracting officers should not enter into contracts that exceed their warrant limitations.

7. Establish procedures to ensure that all future Fund contracts comply fully with AR 215-4, which governs nonappropriated fund contracting procedures.

8. Establish procedures to ensure accurate accountability over foodstuffs at the Consolidated Open Mess.

9. Post a perpetual inventory of keg and bottle beer at the Club.

10. Limit access to the liquor storage area to the manager on duty.

11. To comply with AR 215-4, ensure that all contracts are properly documented.

Comments on Operations

The Fund sustained an operating loss of \$13,155, after depreciation, in its first year of consolidation. Steps have been taken to increase revenues through price increases for selected services. In addition, management is reviewing Club activities to determine the causes of unprofitable operations.

Discussion with Interested Officials

The results of the audit as of October 27, 1989, were discussed with the Chief, Bad Aibling Station, and the Fund Custodian on that date. We held a final exit conference with the executive to the Chief of Station on October 31, 1989.

Weaknesses in Internal Controls

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Controls were not established or effective to adequately protect Fund assets and did not provide for accurate financial reporting. All recommendations in this report, if implemented, will correct the weaknesses. A copy of the final report will be provided to the senior official responsible for internal controls within your Agency.

Management Comments

The NSA Comptroller nonconcurred with the two repeat findings and with Recommendation 8. in the draft report. The Comptroller stated that the recommendations were refinements of actions previously taken. The first repeat finding stated, "Post a perpetual inventory of resale merchandise as each transaction occurs. (Stock records were not maintained for keg and bottle beer in the Club.)" Management stated, "This is not a repeat of the prior audit recommendation but a very specific oversight in the system of stock record cards that has been established." The second repeat finding concerned compliance with Army Regulations that govern contract files. Management stated, "Bad Aibling

Station has prepared new contract files and though specific instances of incomplete documentation were found, the files are in compliance with AR 215-4." Management also nonconcurred with Recommendation 8. in our draft report, which required Bad Aibling Station to comply with AR 215-1, paragraph 3.22.b., regarding extension of credit. Management stated, "Bad Aibling Station is in compliance with AR 215-1 regarding extension of credit. Bad Aibling Station's policies were confirmed with the NAF Accounting Policy Office as being consistent with United States Army-Europe policy."

Audit Response to Management Comments

Based on NSA's comments, we have deleted our recommendation that management post a perpetual inventory of resale merchandise. We have reworded draft report Recommendation 10., (Recommendation 9., in final report) which addressed the posting of a perpetual inventory of resale merchandise as each transaction occurs. The recommendation was changed to read, "Post a perpetual inventory of keg and bottle beer at the Club." Based on the corrective actions taken and noted in management's comments, no other actions are necessary.

Management also nonconcurred with our recommendation that they establish separate files for contract and blanket purchase agreements and maintain these files in accordance with AR 215-4. Management stated that they had complied with the recommendation by establishing separate files for contract and blanket purchase agreements. The audit showed that separate files for contract and blanket purchase agreements were maintained. However, the prior recommendation also stated that these files should be maintained in accordance with AR 215-4. Files were not being properly maintained; therefore, we believe the repeat finding and recommendation are still warranted, for reasons discussed on page 6 of our draft report. In response to Recommendations 6., 7., and 12., (Recommendations 6., 7., and 11., in final report) management stated that the NAF contracting function would be transferred to the Appropriated Fund Procurement Office. Management should first ascertain whether the use of appropriated support is authorized under DoD and Army regulations. If this transfer is authorized, the problems we noted should be solved, and no further action by management will be needed.

We have modified our report to state that Bad Aibling Station has implemented all except one recommendation in the prior reports (Report Nos. 87-151 and 87-150, May 19, 1987).

Management nonconcurred with Recommendation 8., in the draft report concerning the extension of credit. On the basis of NSA's comments, we have deleted draft report Recommendation 8., which addressed the extension of credit to Club members.

Recommendations 9., 10., 11., and 12., in the draft report have therefore been renumbered Recommendations 8., 9., 10., and 11. The full text of management's comments is in Enclosure 2.

Conclusion

We did not identify any monetary benefits in this report, as noted in Enclosure 3. However, the recommendations are intended to improve internal controls over Morale, Welfare, and Recreation operations, and to improve the accuracy of the Fund's financial statements. We request the Director, National Security Agency/Chief, Central Security Service, provide final comments relating to the corrective action proposed for Recommendations 6., 7., and 11., relative to the transfer of the Nonappropriated Fund contracting function to the Appropriated Fund Procurement Office. The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. David R. Stoker at (202) 694-1692 (AUTOVON 224-1692) or Mr. Frank W. Gulla, Jr. at (202) 693-0338 (AUTOVON 223-0338). A list of activities visited or contacted is in Enclosure 4. Copies of this report are being provided to the activities listed in Enclosure 5. Audit team members are listed in Enclosure 6.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc:

Comptroller of the Department of Defense,
Deputy Comptroller (Management Systems)
Assistant Secretary of Defense (Force Management and Personnel)
Assistant Secretary of the Army (Financial Management)

MORALE, WELFARE, AND RECREATION FUND
BAD AIBLING STATION
BALANCE SHEET
AS OF SEPTEMBER 30, 1989

Assets

Current Assets

Cash	\$203,878
Investments	111,371
Accounts Receivable	90,951
Inventories	68,079
Prepaid expenses	<u>12,486</u>

Total Current Assets \$486,765

Fixed Assets

Furniture, Fixtures, and Equipment	\$323,286	1/	2/	
Less Accumulated Depreciation	<u>173,822</u>	<u>1/</u>	<u>2/</u>	<u>149,464</u>

Total Assets \$636,229

Liabilities and Fund Equity

Current Liabilities

Accounts Payable	\$85,533
Ayinger Bar Payable	24,162
Accrued Payroll Expenses	63,784
Unearned Income	<u>2,578</u>

Total Current Liabilities \$176,057

Long-Term Liability

Local National Severance Pay Payable	<u>1,523</u>
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Total Liabilities \$177,580

Fund Equity

Contributed Capital	\$ 43,312
Retained Earnings	<u>415,337</u>

Total Fund Equity 458,649

Total Liabilities and Equity \$636,229

MORALE, WELFARE, AND RECREATION FUND
BAD AIBLING STATION
INCOME STATEMENT
FOR THE YEAR ENDED SEPTEMBER 30, 1989

Sales	\$877,798	
Less Cost of Goods Sold	<u>378,971</u>	
Gross Income From Sales		\$ 498,827
Other Operating Income		
Appropriated Fund Reimbursements	\$468,083	3/
Services and Activities Income	227,358	
Amusement Machine Income	206,942	
Rental and Usage Fees	136,755	
Bowling Fees and Shoe Rentals	42,031	
Concessionaire/Special Events	35,497	
Dues and Assessments	24,079	
Other Operating Income	<u>57,376</u>	
Total Other Operating Income		<u>1,198,121</u>
Gross Income From Operations		\$1,696,948
Operation Expenses		
Salaries	\$1,214,119	
Other Direct Operating Expenses	<u>448,446</u>	
Total Operating Expenses		<u>1,662,565</u>
Net Income From Operations		\$ 34,383
Other Income		24,694
Other Expenses		<u>(8,851)</u>
Net Income Before Depreciation		\$ 50,226
Depreciation Expense		<u>63,381</u> 1/
Net Loss		<u>\$ 13,155</u>

MORALE, WELFARE, AND RECREATION FUND
BAD AIBLING STATION
STATEMENT OF CASH FLOWS
FOR THE PERIOD OCTOBER 1, 1988 TO SEPTEMBER 30, 1989

Net Cash Flow from Operating Activities

Net Loss	(\$13,155)
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Add (or Deduct) Items to Convert Net
Income to Cash Basis

Depreciation Expense	63,381
Loss on Disposal of Fixed Assets	3,756
Increase in Accounts Receivable	(28,707)
Increase in Inventories	(7,771)
Increase in Prepaid Expenses	(4,839)
Increase in Accounts Payable	20,238
Increase in Accrued Payables	24,389
Increase in Unearned Income	577
Increase in Other Liabilities	<u>86</u>

Net Cash Flow from Operating Activities	\$ 57,955
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Cash Flow from Investing Activities

Purchase of Fixed Assets	\$103,726
Increase in Investments	<u>14,221</u>

Net Cash Used by Investing Activities	<u>(117,947)</u>
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Net Decrease in Cash	<u>\$ 59,992</u>
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MORALE, WELFARE, AND RECREATION FUND
BAD AIBLING STATION
FOOTNOTES TO THE FINANCIAL STATEMENTS

- 1/ The Ayinger Bar Payable was established as the result of a contract with a local brewery to build a bar in the Club. Payment was contingent on the amount of beer purchased from the brewery. Management anticipated that the liability for the construction of the bar would be liquidated within 1 year. The liability and fixed assets accounts were also understated by \$1,772. Consequently, it was necessary to increase accumulated depreciation on fixed assets and depreciation expense by \$148.
- 2/ We identified unused computer equipment with an acquisition value of \$13,814. The related accumulated depreciation on those assets was \$11,490, leaving an undepreciated book value of \$2,324. This equipment went unused for at least 1 year. The utility value had not been determined, and Fund management had not decided how to dispose of the equipment. Therefore, the fixed assets and the related accumulated depreciation on fixed assets and retained earnings may be overstated.
- 3/ During the fiscal year ended September 30, 1989, the Fund received \$1.7 million in Appropriated Fund support, of which \$468,083 is shown as Appropriated Fund reimbursements on page 2 of this enclosure.

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